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Supreme Court of the United States

OCTOBER TERM, 1953

NO. [redacted] 55

INDIANA DEPARTMENT OF STATE REVENUE, GROSS INCOME TAX DIVISION, STATE OF INDIANA, *Petitioner,*

vs.

MARK E. NEBEKER, *Respondent*

BRIEF OF RESPONDENT IN OPPOSITION TO CERTIORARI

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Supreme Court of the United States

OCTOBER TERM, 1953

NO. 731

INDIANA DEPARTMENT OF STATE REVENUE, GROSS INCOME TAX DIVISION, STATE OF INDIANA, *Petitioner,*

vs.

MARK E. NEBEKER, *Respondent*

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF INDIANA

BRIEF OF RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinions of the Supreme Court of Indiana (R. p. 27 to p. 28, l. 32, inclusive and R. p. 28, l. 33 to p. 32, l. 26), as yet unreported officially, are unofficially reported in 116 N. E. (2d) 104.

STATUTES AND REGULATIONS INVOLVED

A portion of pertinent statutes and regulations are set forth in the Petition at pp. 4 and 5. However, additional sections of the Indiana Gross Income Statute are necessary for a proper determination of this controversy.

Burns' Indiana Statutes Annotated, 1951 Replacement, Vol. 11, Part 2, Section 64-2601, sub-section (n) is as follows:

> "In case of banks, trust companies, building and loan associations, brokers, dealers in securities, finance companies, dealers in commercial paper and persons engaged in the business of lending money for credit, the term 'gross income' shall be deemed to mean gross earnings, but only in respect to that part of the total gross income of such persons which is derived from the businesses and activities enumerated in this subsection."

And Section 64-2629 (same volume as above) which empowers the director of the Indiana Gross Income Tax Division to promulgate rules and regulations not inconsistent with the Act.

QUESTIONS PRESENTED

1.

Can the State of Indiana constitutionally tax the income of one of its citizens and residents arising from the sale of corporate securities on the New York Stock Exchange, the tax base being the selling price of the securities less the cost price, without any deductions being permitted for losses, or for brokerage fees and other incidental costs of doing business?

2.

Is a regulation promulgated by the Indiana Gross Income Tax Division permitting the deduction of the cost price of securities from the selling price in order to arrive at a tax base valid as to a private investor when the statute authorizes such a tax base only to brokers and dealers in securities?

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3.

Is a tax statute, or a regulation allegedly promulgated under such a statute, unconstitutional which permits persons dealing on margin to deduct cost of acquisition from sales price for arriving at a tax base, but does not afford the same right to persons who pay cash for securities?

4.

If the securities in question were located in New York City in the possession of a broker as a pledge for a loan, had they acquired a business situs outside the State of Indiana, and therefore were beyond the reach of petitioner for tax purposes?

STATEMENT

Respondent, a citizen and resident of the State of Indiana, and a private investor, during the years of 1944, 1945 and 1946 purchased and sold shares of corporate stock. All purchases and sales were handled through brokers maintaining Indiana offices, and were consummated through the New York Stock Exchange. In each instance the certificates of stock were not delivered to respondent in Indiana, but his brokers' books in the State of Indiana showed respondent's stock ownership. The securities actually, that is, the stock certificates, were held by respondent's brokers in New York City, in what is commonly called "street names." The practical effect of having stock in "street names" is that the broker at all times holds stock certificates to the amount of its customers' ownership in the various corporations, and is able to make delivery of the certificates on demand. During all this period respondent had all the attributes of ownership; that is, he could vote or designate the voting of his stock,

he received the dividends thereon, he could sell or pledge the stock, and had the right of possession on demand. During all this period the State of Indiana demanded, and respondent paid, an excise or intangible tax on these identical securities for the privilege of ownership, and its incidents. Petitioner levied, and respondent paid, in the years 1944, 1945 and 1946, a gross income tax of $311.51 thus sold, and provoked the present litigation by claiming refund of the tax so paid.

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ARGUMENT

Respondent feels that this case can be broken down logically for argument into four specifications.

1. This Case Has Already Been Decided By the Supreme Court of the United States.

The case of Freeman v. Hewit (1947), 329 U. S. 249, 67 S. Ct. 274, 91 L. ed. 265, this court held that it was beyond the power of the State of Indiana to levy a gross income tax on a citizen and resident of the State of Indiana who sold corporate securities on the New York Stock Exchange. There is no distinctive fact in the present case that would distinguish it from the case already decided. The slight factual difference was simply that in the case of Freeman v. Hewit (supra) the taxpayer held the stock certificates in the State of Indiana, and mailed them to New York, while in the instant case the certificates of respondent were held in the State of New York.

The universal rule is that a stock certificate is not property, but merely the evidence of ownership, and that one may be a stockholder without ever having been issued a stock certificate.

Blodgett v. Silberman (1927), 277 U. S. 1, 72 L. ed. 749, 48 S. Ct. 410;

Kirkland v. Hotchkiss (1879), 100 U. S. 491, 25 L. ed. 558;

Greenough v. Tax Assessors (1946), 331 U. S. 486, 91 L. ed. 1691

(Concurring Opinion of Justice Frankfurter);

Butler v. Schoonover (1887), 114 Ind. 381;

Markle v. Burgess (1911), 176 Ind. 25;

Brumbaugh v. Mellinger (1918), 68 Ind. App. 410.

Nor is it true, as contended by Petitioner, that a tangible article must be physically shipped across state lines before interstate commerce is recognized. Radio, television, electricity, telephone and telegraph communications are recognized objects of interstate commerce and incident regulations, although intangible in nature.

> Dep't of Financial Institutions v. General Finance Corp. (1949), 227 Ind. 373;
> U. S. v. American Bond & Mortgage Co. (1929), 31 Fed. (2d) 448.

Further, the doctrine of mobilia sequuntur personam, although sometimes criticized as a fiction, is of universal application, and places the situs of intangibles at the domicile of the owner.

Petitioner would make much of the argument that a net income tax is involved, and not a gross income tax. This theory is evolved from the fact that a regulation has been issued by the Gross Income Tax Division which permits a taxpayer buying on margin to deduct cost of securities from the sales price, and Petitioner reasons that the regulation therefore escapes the forbidden territory of burdening interstate commerce by taxing a loss. But the regulation does not permit the deduction of brokerage fees and legitimate expenses connected with the transaction. It becomes apparent immediately, by close examination, that a transaction in interstate commerce yielding a small profit would become a loss when the tax is imposed, and certainly would become a loss which Petitioner would tax when the brokerage fees and incidental costs were taken into account, and that the taxpayer would be paying a tax on a loss.

Another reason why the tax imposed by Petitioner is not a net income tax is the fact that it is strictly a transaction

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tax. In other words, if an investor, such as Respondent, on the same date, and under identical situations, sells different stocks, some reflecting a profit after deducting cost of acquisition, and some reflecting a loss, he will be still taxed on those reflecting a profit, even though the sum total of the daily transactions shows a substantial loss. Such is not a net income tax as has been sustained as a reasonable burden on interstate commerce.

The authority for this proposition advanced by Petitioner is said to be the case of U. S. Glue Co. v. Oak Creek (1918), 247 U. S. 321, 38 S. Ct. 499, 62 L. ed. 1135. But a reading of this case discloses that a true net income tax of the State of Wisconsin was involved, authorizing not only the deduction of costs of acquisition, but also business expenses, so that there could not be in any event a tax without a profit. The court pointed out this very fact, in saying:

> "A tax upon gross receipts affects each transaction in proportion to its magnitude, and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit or loss, or to so diminish the profit as to impede or discourage the conduct of commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. Such a tax, when imposed upon net incomes from whatever sources arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property, and if there is not discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons or corporations otherwise subject to the jurisdiction of the states are

not exempted by the Federal Constitution because they happen to be engaged in commerce among the states."

Respondent submits that this case has already been decided by this court, and further, that the decision of the Supreme Court of Indiana was correct.

2. Regulation 2805 is Void

This regulation, promulgated by the Gross Income Tax Division, permits persons dealing in margin accounts to deduct the costs of securities from the selling price, without deductions for losses. Section 64-2629, Burns' Annotated Statutes, Vol. 11, 1951 Supplement, empowers the Director of Gross Income Tax to promulgate rules and regulations not inconsistent with the act. There is nothing in the act that would authorize such a regulation; as a matter of fact the regulation is contrary to the act itself. The only pertinent provision of the act is Section 64-2601, but it permits a gross earnings basis (deduction of cost from selling price) only to banks, trust companies, building and loan associations, brokers, dealers in securities, finance companies, dealers in commercial paper and persons engaged in the business of lending money for credit. Any attempt by the director to extend the scope of the statute by regulation to people in general, and the respondent, a private investor, would be void. Hence, there is no legal admeasurement of tax as to respondent's transactions in interstate commerce.

3. Regulation 2805 is Void As Discriminatory

This regulation purporting to permit persons dealing in margin accounts to deduct cost from selling price is an illegal discrimination under the 14th Amendment in that it creates a favored class in those who borrow money to

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purchase securities as against those who pay cash for securities. Legally there is no distinction between those who buy on margin and those who purchase outright. In either case, legal title is vested in the purchaser, but as to the margin buyer his stock is encumbered with a pledge. There seems to be no valid reason as to why a margin buyer should be favored. As a matter of fact there have been so many economic evils in the past with regard to margin buying that it would seem that if there was to be any discrimination it would be in favor of the cash buyer.

Hartford S. B. I. & Ins. Co. v. Harrison (1936), 301 U. S. 459, 81 L. ed. 1223, 57 S. Ct. 838.

4. Petitioner's Position Would Create a Business Situs in New York.

Petitioner has insisted that respondent was dealing on margin with respect to the securities here involved, meaning that respondent had borrowed money from his brokers to purchase the securities. Accepting this as true for the purpose of argument, then the stock certificates were held in New York as a pledge for advancements, with the brokers having the first right to collect the dividends, vote the stock as they desired, if not otherwise directed, and to sell the stock in case of respondent's default. Assuming these facts to be true, the stock would have acquired a business situs in the State of New York, and would have been beyond the reach of the State of Indiana.

First Bank Stock Corp. v. Minnesota (1936), 301 U. S. 234, 86 L. ed. 1061, 57 S. Ct. 677;
Miami Coal Co. v. Fox (1931), 203 Ind. 99.

CONCLUSION

In order to escape the effect of the opinion of the Honorable Court in the case of Freeman v. Hewit (supra) petitioner insists that a net income tax is here involved for the reason that under Regulation 2805 (supra) a marginal buyer of securities may deduct the cost of the securities from the selling price in order to determine if a taxable profit has been made. But the balance of the regulation providing that losses may not be deducted, and that brokerage commissions and other expenses connected with the transaction may not be deducted, makes it transparent that even under this regulation petitioner would levy a tax upon such transactions that resulted in a substantial loss to the taxpayer. So the tax that petitioner would impose is not a net income tax in any respect, and under the authority cited by petitioner, U. S. Glue Co. v. Oak Creek (supra) it falls far short of the requirements of this Court announced in the Glue Co. case in that the imposition of the tax could "make the difference between profit or loss, or to so diminish the profit as to impede or discourage the conduct of commerce."

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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